



N A R U C
National Association of Regulatory Utility Commissioners

July 17, 2000

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Chairman Kennard
Office of the Chairman
Federal Communications Commission
445 Twelfth Street, S.W., TW-A325
Washington, D.C. 20554

RE: Ex Parte - Two Copies filed in the Depreciation Rulemaking: *In the Matters of 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers; CC Docket No. 98-137, Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, et al.; CC Docket No. 99-117; GTE Telephone Operating Companies Release of Information Obtained During Joint Audit. AAD File No. 98-26*

Dear Chairman Kennard:

The National Association of Regulatory Utility Commissioners ("NARUC") submits this *ex parte* filing in response to the June 1, 2000 *ex parte* letter filed jointly by the incumbent local exchange carriers ("ILECs") participating in the Coalition for Affordable Local and Long Distance Service ("CALLS") plan. Before responding to the specifics of the June 1 *ex parte* letter, however, NARUC wishes to make clear why the States have a clear and significant stake in the pending action proposed in the Federal Communications Commission's ("FCC" or "Commission") Further Notice of Proposed Rulemaking ("FNPRM") in CC Docket 98-137 with respect to depreciation accounting.

STATE INTEREST IN FCC ACTIONS ON DEPRECIATION ACCOUNTING

The FNPRM sets out a proposal that, in short, would allow an ILEC to opt for depreciation deregulation if it agrees to adjust the net book costs on its regulatory books to the level reflected in its financial books, amortize the difference between its regulatory and financial books above-the-line over a five year period, and commit not to recover from customers any of this amortization. The FNPRM specifically asked the ILECs if the commitment not to recover any of the amortization included both the interstate and intrastate portions. Even though the ILECs have provided various responses to this question, their commitment not to recover the intrastate portion of the amortization remains an outstanding issue.

It is essential that if the FCC adopts the above-the-line amortization proposal in the FNPRM, the ILECs must be precluded from recovering both the interstate and intrastate portions of the total amount subject to amortization, i.e., the full difference between their financial and regulatory books. If the FCC adopts an above-the-line amortization procedure without a clear and explicit requirement that the intrastate portion of the amortization cannot be recovered in customer rates, a substantial burden will be placed on State regulators to prevent adverse rate impacts on consumers. However, the pivotal question is whether the FCC can impose such a requirement, and even if it can, whether the FCC has the authority to enforce such a requirement. This is the single most important concern to the States if the Commission adopts an above-the-line accounting solution.

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Above-the-line FCC treatment would lead to large increases in the State jurisdictional depreciation expenses. Under the FCC's separations rules, approximately 75%, or \$4.5 billion per year in additional costs, would be designated as intrastate. If this happens, the onus will be on the individual States to require below-the-line treatment and to prevent serious adverse consumer impacts.

While the individual States clearly have the authority under the *Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986) ("*Louisiana*") to set depreciation rates for State ratemaking purposes, in spite of this it will be very difficult for States to prevent recovery of the additional costs the ILECs will report under the proposal set forth in the FNPRM. Under *Louisiana*, if a State decides to use a different pattern of depreciation expense from that used by the FCC, it can readily do so and require the company to make off-book adjustments to ensure no over- or under-recovery. But, for States to disallow billions of dollars that the FCC has designated for above-the-line treatment is another matter altogether, involving complex constitutional issues such as takings claims.¹

An additional concern with above-the-line treatment is it will create the rebuttable presumption that financial depreciation parameters are valid and appropriate for all purposes. The ILECs have already Stated in their filed comments to the FNPRM that the FCC's approval of the depreciation proposal will represent the Commission's "endorsement" of financial depreciation factors for regulatory purposes. An above-the-line decision will simply exacerbate the situation and will make it much more difficult for States to use depreciation factors other than the ILEC's financial depreciation factors for the determination of Unbundled Network Elements (UNE) or interconnection rates.

As is shown on the attached Appendix A Table, NARUC's research has identified only three States that currently use financial depreciation factors for determining UNE prices.² This appears a clear indication that States do not find financial depreciation factors reasonable or justified.

It would be unfortunate and unreasonable if the FCC were to decide to use above-the-line treatment with no clearly enunciated benefit at the federal level and with a real and large liability at the State level. Indeed, it is a peculiar approach - especially coming from an agency of the federal government charged with acting in the public interest.

THE ILEC JUNE 1 EX PARTE TABLE IS MISLEADING AND ANY CONCLUSIONS RESULTING FROM IT ARE UNRELIABLE

NARUC has reviewed the information provided in the table attached to the ILEC June 1 *ex parte* purporting to depict States' actions regarding depreciation rates and regulatory/financial reserve differences. NARUC finds the ILEC's table, which contains no citations to any State commission action, misleading and begging for clarification. Any conclusions drawn from this unsupported information cannot be meaningful, given the built-in bias of the analysis the table purports to undertake.

¹ Indeed, at least one State has already ordered below-the-line treatment. The FCC designating the corresponding interstate plant as above-the-line could form the basis for a constitutional confiscation argument before that State commission. As the FCC is aware, based on filed *ex parte* notices, it appears, that *at least two* State Commissions believe that the *Louisiana* decisions= general guarantee of State authority over depreciation counters these concerns.

² The Appendix A Chart was compiled by a direct survey of the listed State commissions by the Staff of NARUC's Finance and Technology Committee.

For example, the second column of the ILEC table entitled "Are State depreciation lives/rates the same as the FCC's?" is extremely misleading and simplistic. While it is true that some State prescribed lives are longer than FCC lives and some are shorter, in most cases, the life estimates are similar. All it takes for the ILECs to indicate "no" in this column, is that one account has a different rate or life than the FCC's. The ILECs' analysis is so simplistic as to be meaningless.

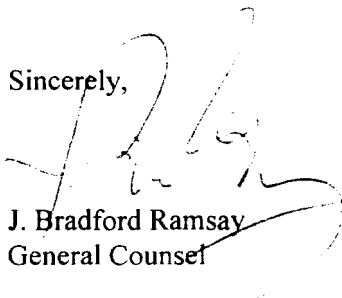
The other columns are even more misleading. The ILECs imply that 34 States are reducing the difference between ILECs' regulatory and financial books and allowing above-the-line treatment in doing so. As MCI points out in its June 9, 2000 *ex parte* letter, the vast majority of States have not approved any plan designed to reduce the difference between the regulatory and financial books. *In fact, NARUC's research identified only four States who have actually addressed and approved depreciation recovery of the regulatory and financial reserve difference. Additionally, only two of those States have ordered an above-the-line treatment of the amortization with one State ordering below-the-line treatment.* The information shown on the attached Appendix A table, along with information submitted by MCI, provides an excellent, and well-documented, synopsis of the current environment in the State arena. We urge the Commission to consider carefully the information provided in MCI's June 9 *ex parte* letter.

NARUC urges the FCC to carefully consider the significant risks associated with an above-the-line treatment before making its final decision in granting depreciation relief. An above-the-line treatment decision would undoubtedly burden the State commissions, and could lead to substantial pressure to increase local rates.

Finally, we would like to point out that, according to NARUC's March 8, 2000 Resolution, approved at our last meeting by the Board of Directors, the association has formally taken the position that *the current level of FCC depreciation oversight is appropriate, protects consumers, and should continue as long as depreciation represents a significant portion of access charges and universal service funding levels.* The resolution also specifically states the conditions for forbearance adopted December 17, 1999 by the FCC in its Report and Order in CC Docket No. 98-137, Memorandum Opinion and Order in ASD 98-91, provide customer protection while promoting competition. *The December Order contemplates neither above-the-line treatment nor the resolution of the CPR audits suggested in the ILEC proposal.*

As always, if you have any questions about this, or any other NARUC positions, please do not hesitate to give me a call at 202.898.2207.

Sincerely,



J. Bradford Ramsay
General Counsel

Cc: Commissioner Ness
Commissioner Powell
Commissioner Tristani
Commissioner Furchtgott-Roth

APPENDIX A - STATE DEPRECIATION ANALYSIS

NAME	HAS STATE APPROVED DEPRECIATION RECOVERY OF THE REGULATORY/FINANCIAL RESERVE DIFFERENCE?	HAS STATE ORDERED ACCOUNTING TREATMENT OF RECOVERY?	HAS STATE ORDERED USE OF FINANCIAL DEPRECIATION FACTORS IN UNES?
Alabama	No	No	No
Alaska			
Arizona	No	No	No
Arkansas	No	No	No
California	No	No	Yes
Colorado	No	No	No
Connecticut	Yes	Yes, Above-the-line	Yes
Delaware	No	No	No
District of Columbia	No	No	No
Florida	No	No	No
Georgia	No	No	No
Hawaii	No	No	No
Idaho	Yes	Yes, Below-the-line	Not addressed yet
Illinois	No	No	No
Indiana	No	No	No
Iowa			
Kansas	No	No	Yes
Kentucky	No	No	Mix*
Louisiana	No	No	No
Maine	No	No	N/A
Maryland	No	No	No
Massachusetts	No	No	No
Michigan	No	No	No
Minnesota	No	No	No
Mississippi	No	No	No
Missouri	No	No	No
Montana	No	N/A	No

NAME	HAS STATE APPROVED DEPRECIATION RECOVERY OF THE REGULATORY/FINANCIAL RESERVE DIFFERENCE?	HAS STATE ORDERED ACCOUNTING TREATMENT OF RECOVERY?	HAS STATE ORDERED USE OF FINANCIAL DEPRECIATION FACTORS IN UNES?
Nebraska	No	No	No
Nevada	No	No	No
New Hampshire	No	No	No
New Jersey	No	No	No
New Mexico			
New York	Yes (BA)	Yes (BA), Above-the-line	No
North Carolina	No	No	No
North Dakota	No	No	Under Review
Ohio	No	No	No
Oklahoma	No	No	No
Oregon	No	No	Under Review
Pennsylvania	Yes (BA)@	No	No
Rhode Island	No	No	Under Review
South Carolina	No	No	No
South Dakota			
Tennessee	No	N/A	No
Texas	No	N/A	No
Utah	No	No	No
Vermont			
Virginia	No	No	No
Washington	No	No	No
West Virginia	No	No	Mix*
Wisconsin	No	No	No
Wyoming			

* A mix of FCC prescribed lives and company financial lives.
A Action approved as result of time expiration regarding company proposal.

***Appendix B - Resolution Regarding the Forbearance from Depreciation Regulation of
Price Cap Local Exchange Carriers***

WHEREAS, Depreciation represents a significant portion of access charges and universal service funding levels and therefore plays a major role in the establishment of these funding levels; and

WHEREAS, A complete forbearance of the depreciation prescription process may be harmful to customers and competitors through overstated funding levels resulting from unreasonable depreciation rates; and

WHEREAS, A complete forbearance of the depreciation prescription process could potentially trigger large increases in a carrier=s depreciation expenses, which could in turn result in unwarranted increases in customer rates; and

WHEREAS, A complete forbearance of the depreciation prescription process may impede competition by raising prices for interconnection and Unbundled Network Elements (UNEs); and

WHEREAS, The Federal Communications Commission=s oversight of depreciation provides States additional sources of information for consideration in the determination of prices for UNEs, fair and reasonable rates for basic local service, and intrastate universal service cost levels; *now therefore be it*

RESOLVED, That the Board of Directors of the National Association of Regulatory Utility Commissioners (NARUC), convened in its March 2000 Winter Meetings in Washington, D.C., believes the current level of FCC depreciation oversight is appropriate, protects consumers, and should continue as long as depreciation represents a significant portion of access charges and universal service funding levels; *and be it further*

RESOLVED, That the conditions for forbearance adopted December 17, 1999 by the FCC in its Report and Order in CC Docket No. 98-137, Memorandum Opinion and Order in ASD 98-91, provide customer protection while promoting competition.

Sponsored by the Committee on Finance and Technology

Adopted by the NARUC Board of Directors, March 8, 2000